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MEMORANDUM

To: Amy Bodek, Project Development Bureau Manager
City of Long Beach

From: Cal Hollis

Date: August 4, 2004

Subject: PacifiCenter Development Agreement – Mixed-Use Development Option

You have asked Keyser Marston Associates, Inc. (KMA) to present an outline of the rationale for recommending a mix of residential and commercial uses at the subject development site.

BACKGROUND

The City of Long Beach and Boeing Realty have been negotiating the terms of a statutory development agreement to govern the development of approximately 240 acres immediately adjacent to the Long Beach Airport. Historically, the property has been used for aircraft manufacturing. The reduction in Boeing's manufacturing has resulted in approximately 200 acres being available for alternative use, reserving approximately 40 acres for continued aircraft testing and delivery activities. Ultimately this remaining aircraft-related use will be phased out as well. Boeing has proposed that the permitted land uses be changed to allow residential development on the northerly 100 acres of the site, and commercial uses be permitted on the remaining property. Commercial uses have been defined to exclude stand-alone warehousing and distribution uses. The number of residential uses has been the subject of negotiation with the range being between 1,400 and 2,500 units. As of this date, Boeing has agreed to reduce the number of residential units to approximately 1,400 units. An EIR has been prepared for the development of the site as proposed.

To bring the property to the market, Boeing Realty will incur substantial site remediation and infrastructure costs. It has been the position of the City's negotiating team that the cost of remediation is not a factor in the viability of the site's development. The remediation is pursuant to a regulatory order and is being undertaken regardless of the ultimate disposition of the property. The infrastructure cost, estimated at over $40 million in addition to any extractions negotiated as part of the development agreement, is a significant factor to be considered in the site's entitlement. The willingness of Boeing to make this investment, will be in a large measure dependent upon its forecasting an acceptable return on this investment over a reasonable development horizon.

CURRENT MARKET CONDITIONS

As proposed, the site would be entitled for approximately three million square feet of commercial development. In addition to the site, commercial properties adjacent to the Long Beach Airport have over 300,000 square feet of un-built, entitled commercial space at Kilroy and the Airport Business Park. Over the last several years, the commercial leasing market in and around the Airport Area has remained very soft. The following data was provided to the City from Cushman and Wakefield:

- Total Airport Area Inventory 2.1 million square feet
- Direct Vacancy 167,000 square feet (8%)
- Sublease Vacancy 34,000 square feet (1.6%)
- Total Airport Vacancy 9.6% including sublease space
- Greater Market Area Vacancy 10.8% including sublease space
- Asking Rent for Direct Lease Space $1.83 full service, substantially below the $2.50 necessary to support new construction.
- The above data excludes vacancies in Carson and the Dominquez Hills Technology projects which totals an additional 2.8 million square feet in available or entitled space.
- Leasing continues to be a struggle, with the Airport Area reporting negative absorption in the 1st quarter 2004 of 18,000 square feet. The absorption for the entire 405/710 corridor, Bixby Knolls, East Long Beach and the Long Beach Airport was only 14,000 square feet. Vacancy in Class A buildings in downtown average 12% and in Class B buildings averaged 17.4%.

The conclusion from this data is that absent a significant and rapid improvement in the regional economy, the prospect of leasing large amounts of commercial space at rates that support new construction is very bleak.

IMPLICATIONS FOR A MIXED-USE STRATEGY

Given the above market data with respect to commercial office development, the choices facing Boeing Realty are as follows:

1. Remediate the site at a cost of $60 million, entitle the site for six million square feet of commercial space, and invest an additional $40 million plus in infrastructure (over several phases) on the assumption that the area will experience a significant improvement in its commercial market to create a return on the $40 million.

2. Remediate the site and sell at a substantial discount in an un-entitled state.

3. Remediate the site and suspend entitlement and development activities until the market recovers, recognizing that the residential market could deteriorate.

4. Remediate the site; seek entitlements for a mix of residential and commercial development with the sufficient density residential to absorb the cost of infrastructure for the entire site.

Boeing Realty's consultants have concluded that the site, if developed as a commercial/ industrial business park, could not expect to absorb more than 200,000 square feet per year, including industrial space. This would suggest a total buildout of six million square feet would take 30 years and 15 years for three million square feet. Given this extended absorption period, it is highly unlikely Boeing could justify the $40 million in infrastructure capital necessary to put the entire property into a developable condition or even the $20 million+ necessary for the initial 100 acres of commercial development. If this analysis were correct, the likely course of action for Boeing would be to reject Alternative 1.

Alternatives 2 and 3 would likely not result in near-term development. The sale at a substantial discount does not change the market forces where rental rates today do not support the cost of new construction, particularly given the infrastructure cost and the likely front-loading of mitigation costs. Given the inability to foresee absorption of the commercial space during a reasonable time period, and thus receive a return on its infrastructure investment, Alternative 3 is a highly likely alternative. Boeing would have completed its obligations with respect to remediation, and can mothball the asset to deal with in the future when local conditions may improve.

It was this analysis that led KMA to support the Alternative 4. Under this approach, as a condition of developing residential, Boeing is obligated to complete all the necessary grading and infrastructure improvements necessary to present the commercial portion of the site to the market in a buildable condition. The presence of significant acreage, improved and ready to develop, we concluded, would greatly increase the competitiveness of the site for industrial/ office users looking for space and results in the highest likelihood of near-term development. In this regard, the increased probability of near-term job generating commercial spaces was found to be preferable over a much longer term, although potentially greater job generation is possible in Alternatives 2 and 3 above.

We hope this review is helpful and are available to discuss the above at your convenience.